California Dept of Veterans Affairs Upgraded, Series 1999 Bonds Rated `AA-' and `AA-/A-1+'

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NEW YORK (Standard & Poor's CreditWire) March 5, 1999--Standard & Poor's today assigned its double-`A'-minus rating to California Department of Veterans Affairs' $139.8 million home purchase revenue bonds series 1999A and B dated March 1, 1999, and to the department's $120 million GO veterans bonds series 1999 BQ, BR1, BR2, and BR3 dated April 1, 1999, which were issued for the state.

Standard & Poor's also assigned its double-`A'-minus/`A-1'-plus ratings to the department's $ 252 million convertible obligation veterans GO bonds series 1999BJ3 and BJ4 dated April 1, 1999 due April 1, 2001, and $100 million home mortgage revenue bonds series 1997C.

The revenue bonds are scheduled to sell March 17, 1999 and the GO bonds are scheduled to sell April 14, 1999.

At the same time, Standard & Poor's raised its ratings on the department's outstanding GO and revenue bonds (see list).

The rating upgrade to double-`A'-minus from single-`A'-plus on the veterans GO bonds and home purchase revenue bonds reflects:

-- The overall strength of the assets in the Veterans Farm and Home Building Fund of 1943, represented by contracts of purchases and investments;

-- The successful implementation of programmatic changes that effectively reduce the risk of losses for the program and help sustain the program's long-term viability;

-- The resiliency of the consolidated cash flows through various stress scenarios simulating different prepayment and loss scenarios; and

-- Good investments and the structure of the program.

The ratings on the convertible option bonds reflect the sufficiency of the principal investment along with investment income to pay interest and principal due until the initial interest reset date. Bond proceeds will be utilized to refund and remarket a portion of existing bonds, originate new purchase contracts, and pay costs of issuance.

The department successfully implemented both programmatic and financial steps to help increase demand for the program and effectively transfer a portion of the program risks to outside sources. The department effectively:

-- Enacted legislation that eliminated the uniform interest requirement, thereby allowing new purchase contracts originated after Jan. 1, 1999 to establish new variable- or fixed-rate loans;

-- Lowered the interest rate on the existing contracts to 6.95% from 8% on Jan. 1, 1998 for approximately 95% of the purchase contracts;

-- Started to expand loan originations by utilizing mortgage brokers certified by the department;

-- Increased the pool of eligible veterans to include Gulf War and peace time veterans;

-- Obtained insurance with Commonwealth Mortgage Assurance Co. for the majority of the high loan-to-value loans; and

-- Began originating high loan-to-value loans with loan guarantees from the Department of Veterans Affairs.

It is crucial that the program continues to originate new purchase contracts to increase revenues. The department has substantially increased originations following the 1997 restructuring, which helped to effectuate sufficient savings to allow for the interest-rate reduction. Lowering the contract interest rates has served to ensure that the program's interest rate is competitive with the market and also limit the negative spread between some noncallable GO bonds and the purchase contracts.

The 1943 fund maintains retained earnings as of June 30, 1998 equal to approximately $278 million. This is an increase of about $4 million from 1997 and the first time in five years that the department has achieved an increase in retained earnings. The turnaround is mainly attributable to gains the department achieved through the sale of certain investments. The department also effectively outsourced life, disability, fire, and hazard insurance risks. This has helped to decrease operating losses on an annual basis. During 1997, the department hired outside consultants to help reassess the program and wrote down their existing real estate owned portfolio, which has decreased considerably and is now more in line with Mortgage Bankers Association statistics.

The GO veteran bonds are also secured by the state of California in addition to the assets within the 1943 fund. The revenues derived from the assets of the Veterans Farm and Home Building Fund of 1943 will repay the state in the event state monies are utilized to pay debt service. The 1943 fund and the bond reserve fund secure the revenue bonds. The revenue bonds' interest in the assets of the 1943 fund is secondary and subordinate to any interest of the GO bondholders. However, excess funds will be used to call the subordinate bonds in the event that the asset to liability ratio for the subordinate bonds falls below 150%. Under a contract of purchase, the veterans have the benefits of ownership but title to the property is held by the department until the final principal payment is made. If there is a missed payment under the contract, the veteran relinquishes all rights in the property. In addition to providing monies for home purchases, the department had previously provided insurance that is also secured by the 1943 fund. This insurance exposure has either been outsourced or reserved for by the department.

Standard & Poor's analysis of the financial feasibility of the resolution reveals a strong likelihood that the revenues from the 1943 fund will be sufficient to pay debt service and fees on all bonds. The resiliency of the issue was tested under various origination and prepayment scenarios. All cash flows are run assuming a 30-day payment lag and a last-day origination for the new contracts of purchase. The consolidated cash flows reflect maximum losses in the amount of about $125 million in conjunction with various prepayment scenarios. The cash flows continue to reflect a drag due to the negative spread between the assets and certain noncallable GO bonds. The resolution should improve considerably as the high coupon bonds are paid off.

OUTLOOK: STABLE

The outlook reflects the expectation that the implemented changes will remain in place and the resolution will continue to perform strongly with sufficient excesses to withstand any additional losses and maintain the high asset to liability position, Standard & Poor's said. – CreditWire

OUTSTANDING CALIFORNIA DEPARTMENT OF VETERANS AFFAIRS RATINGS RAISED

	Rating	
	To	From
$269.13 million home purchase revenue bonds series 1997A, 1997B, 1998A	AA-	A+
$48.5 million convertible obligation veterans GO bonds series 1997BJ 1 & 2	AA-/A-1+	A+/A-1+
$2.3 billion GO veterans bonds*	AA-	A+

*Obligor: State of California.